Department of Veterans Affairs

Office of Inspector General

Evaluation of

VA Capital Programming

Practices and Initiatives

VA is making good progress toward a comprehensive capital program. Policy is needed for network-level investments, and alternative capital funding strategies should be explored.

Report No. 8R8-A19-061
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Office of Inspector General
Washington DC 20420

DEPARTMENT OF VETERANS AFFAIRS
Office of Inspector General
Washington DC 20420

Memorandum to:
Acting Assistant Secretary for Management (004)
Under Secretary for Health (10)

Evaluation of VA Capital Programming Practices and Initiatives

1. The Office of Inspector General (OIG) performed an evaluation of Department of Veterans Affairs (VA) capital asset acquisition practices and efforts to implement a capital programming process. The Office of Management and Budget (OMB) defines capital programming as a comprehensive process for planning, budgeting, procuring, and managing capital assets. VA capital assets include land, structures, equipment, intellectual property, and information technology hardware and software. In VA, the Assistant Secretary for Management is responsible for capital programming policy and oversight, and the Department's three administrations are responsible for formulating and executing capital acquisition plans and budgets. In Fiscal Year (FY) 1997, VA's capital investment costs were about $1.33 billion. Of this amount, the Veterans Health Administration (VHA) accounted for the largest portion, $1.17 billion, or 88.0 percent.

2. In recent years, OMB and Congress have established new guidelines and requirements for agencies to use in planning and budgeting for capital assets. The most important and definitive new guidance is OMB's July 1997 Capital Programming Guide, which describes the requirements of recent reform legislation and lays out a comprehensive set of principles for managing capital investments for the entire asset life cycle, from project inception through disposal.

3. Historically, VA has not had a comprehensive capital programming process. VA did not always consider alternatives to proposed capital asset acquisitions and did not use benefit-cost analysis to support capital decisions. In response to the new Federal requirements, VA and VHA have undertaken several initiatives to address capital investment issues. In June 1997, VA established the Capital Investment Board (CIB) to provide oversight on VA capital investment policies and to review high cost, high risk capital proposals. As part of the new strategic planning process, VHA has required the Veterans Integrated Service Networks (VISNs) to develop capital plans that show how proposed assets are linked to strategic goals. The VISN capital plans will be rolled into the VHA and VA agency capital plans now required as part of the OMB budget process. In addition, the CIB and VHA now require that proposals for high cost acquisitions include consideration of alternatives and be supported by benefit-cost analyses.

4. Our review concluded that the recent initiatives are steps in the right direction. To continue progress toward a comprehensive capital program, the VA Office of Management and VHA need to address two issues. First, policy is needed for capital investments that are controlled at the VISN level. Thus far, VA's efforts have focused on high cost investments that require VA Central Office approval. However, most capital decisions are now made at the VISN level, and current policy does not specify to what extent capital programming principles and techniques should be applied to investments that fall below the VA Central Office review thresholds and that are controlled by the VISNs. In FY 1998, these VISN-controlled investments could amount to as much as $979.6 million, or 95.4 percent of VHA's proposed FY 1998 capital expenditures.

5. Second, VA and VHA planners have had to make capital investment decisions within the constraints of a funding process that provides two separate sources of capital funds -- the medical care appropriation, for nonrecurring maintenance projects, equipment, and leases, and the construction appropriation, for major and minor construction projects. Because they have been restricted by the funding process, planners have not been able to make good use of benefit-cost analysis and have sometimes had to choose the more costly capital alternative simply because funds were available from one appropriation source but not from the other. To alleviate problems caused by the funding process, VA should evaluate the feasibility of using alternative funding strategies, such as a single capital investment appropriation, a working capital investment fund, or revolving funds.

6. To address these two issues, we recommended that the Office of the Assistant Secretary for Management and VHA work together to: (a) develop policy on VISN-controlled capital investments; (b) provide VISN staff with technical guidance on capital programming principles and methods, with emphasis on consideration of investment alternatives, benefit-cost analysis, and post-implementation reviews; and (c) explore the feasibility of using alternative strategies for funding capital investments.

7. The Acting Assistant Secretary for Management and the Under Secretary for Health concurred with the recommendations and provided acceptable implementation plans. The Office of the Assistant Secretary for Management, the Capital Investment Board, and VHA have begun efforts to develop new policy guidance for VISN-controlled capital investments, benefit-cost analysis, and other capital programming steps. The new guidance should be issued by September 30, 1998. In addition, the Office of the Assistant Secretary and VHA have had preliminary discussions on the feasibility of adopting new capital funding strategies. Further discussion and review are planned, with the aim of resolving the funding issues during the FY 2000 budget process. We will follow up on the implementation of planned actions.

For the Assistant Inspector General for Auditing

(Original signed by:)
DAVID SUMRALL
Director, Seattle Audit Operations Division

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Results and Recommendations

Better Guidance and Exploration of Alternative Funding Strategies Would Improve VA Capital Programming

VA and the Veterans Health Administration (VHA) have recently taken positive steps toward developing an effective capital programming process.[1] To develop a more comprehensive process, two issues need to be addressed. First, VA and VHA efforts thus far have focused on high cost capital investments that require VA Central Office approval. However, decisions made at the Veterans Integrated Service Network (VISN) level account for about 95.4 percent of VHA capital expenditures. To help ensure that VISN staff make sound capital decisions, VA and VHA need to develop policy on VISN-controlled investments and to provide local staff with technical guidance on evaluating capital proposals. Second, VA's capital programming efforts have been hindered by a funding process that provides only two sources of funds for capital assets, the medical care appropriation and the construction appropriation. This funding process can result in the selection of more costly capital alternatives simply because funds are available in one appropriation and not in the other. To promote cost-effective investments, VA should explore, with OMB and Congress, the feasibility of using alternative capital funding strategies.

VA Has Begun Improving the Capital Planning Process

Consideration of Alternatives and Benefit-Cost Analysis Are Key to Effective Planning. The first element of capital programming is capital planning, and two of the most important planning steps are (1) the consideration of alternatives to the proposed capital investment and (2) a benefit-cost analysis of the investment versus the alternatives. After making sure that a proposed investment is linked to strategic goals and addresses a real need, the most important decision that must be made is whether to consider alternatives to the proposal. If alternatives are not to be considered, then there is little need to proceed to the benefit-cost analysis. The Office of Management and Budget (OMB) Capital Programming Guide emphasizes the importance of Federal managers carefully considering alternatives before acquiring new capital assets. OMB recommends that managers evaluate alternatives by asking "three pesky questions:"

- Is the function the asset will support tied directly to the agency mission?
- Can another agency, government, or private entity support the function better?
- Have work processes been reengineered to give best performance at lowest cost?

The Capital Programming Guide emphasizes that in making a capital investment decision the selection of the best alternative should be based on a systematic economic analysis of expected benefits and costs. Benefit-cost analysis includes: identifying assumptions and constraints;

[1] In this report we use the term "capital programming" generically to cover the entire capital investment process which includes planning, budgeting, acquisition, and in-use management of capital assets. In VA, the most commonly used generic terms are "capital budgeting" and "capital planning." However, OMB encourages the use of the term "capital programming."

quantifying benefits and costs; evaluating alternatives using net present value (NPV); and performing risk and sensitivity analysis. OMB budget and planning guidance now requires that projects in agency capital plans be supported by benefit-cost analysis.[2]

VA Has Usually Not Considered Alternatives to Proposed Capital Investments. VHA accounts for the largest portion of capital costs, and most proposals to acquire new assets pertain to veterans healthcare activities, with construction being the most costly category of assets. Historically, VHA has given little consideration to alternatives to acquiring new assets, particularly alternatives to constructing new facilities. There are two major reasons for this:

- The legislation governing VHA operations has generally emphasized and supported the delivery of healthcare in an inpatient setting using VA-owned and operated facilities. This healthcare model has been favored by VA policy makers and by affiliated medical schools. As a result, other options, such as obtaining care from outside sources through contracts or sharing, were not the preferred approach.

- VA medical center (VAMC) managers generally did not consider alternatives because they did not have to pay for capital investments out of their own operating budgets. Instead, funding typically was provided from accounts controlled by VHA Central Office. VAMC managers had little incentive to seek less costly alternatives because they did not have to set aside or "save" funds for capital projects from their operating budgets, nor did they have to repay capital debt, as would be the case in the private sector. Alternatives, on the other hand, would typically have to be funded out of a VAMC's operating budget. For example, if a VAMC wanted to contract out instead of acquiring a new asset the contract cost would have to be paid from the operating budget, whereas the new asset would be funded by VHA Central Office.

The recent proposal to construct a new hospital in Brevard County, Florida illustrates the difficulty VHA has had in considering alternatives to building new facilities:

> In its FY 1996 budget submission VHA requested $154.7 million for a 470-bed hospital, an outpatient clinic, and two 120-bed nursing homes to address the healthcare needs of the growing veteran population in east central Florida. Before making this request, VHA had not seriously considered alternatives to building the new inpatient facility. After receiving the VHA request, Congress asked the General Accounting Office (GAO) to evaluate the need for the project. GAO concluded that the project was not the most prudent and economical use of resources.[3] As a result of the GAO review, Congress denied the budget request and required VA to reevaluate the options for providing services in east central Florida. In March 1997, VA released the evaluation results, which acknowledged that there were feasible alternatives to the original proposal and recommended contracting for some services, making more use of other VA facilities, and

[2] OMB Circular A-11, Part 3, Planning, Budgeting, and Acquisition of Fixed Assets, July 1996.
[3] GAO, VA Healthcare: Need for Brevard Hospital Not Justified (GAO/HEHS-95-192), August 1995.

building only an outpatient clinic instead of the hospital and only one instead of two nursing homes.

The Brevard decision showed that by objectively analyzing workload trends and seriously considering the use of community resources it was possible for VA to find feasible and less costly alternatives to the traditional approach for providing veterans healthcare.

VA Has Made Limited Use of Benefit-Cost Analysis. Historically, VA and VHA have based capital asset decisions on largely subjective judgments about how the proposed investments met program goals and priorities. The decision-making process has typically placed little or no emphasis on benefit-cost analysis. To illustrate, the major construction prioritization system, which was used to evaluate and rank major construction proposals, did not include a benefit-cost component. Likewise, the justification processes for minor construction and nonrecurring maintenance (NRM) projects did not require benefit-cost information. The process for setting priorities on major equipment proposals did require some benefit-cost information. However, a 1995 OIG audit found that most proposals reviewed did not have this information.[4]

VA's recent experience with the proposed Travis hospital project illustrates the usefulness of benefit-cost analysis in evaluating alternatives for delivering services:

> In 1992, VA proposed building a $211 million, 243-bed hospital to be co-located with the existing Travis Air Force Base hospital. The hospital would have replaced VAMC Martinez, which was closed in 1991 because of earthquake damage. In a 1996 report, GAO concluded that events had overtaken the project and that it was no longer justified based on reduced future patient demand, changes in VA healthcare delivery, and available capacity in non-VA hospitals.[5] As a result of the GAO report, Congress delayed the project and required VA to study options.
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> VA contracted with a consulting firm to conduct the required study. The consultants evaluated the original Travis project and eight alternatives. The evaluation covered concerns such as patient access, availability of care, costs, VHA's unique missions, and sharing. The consultants analyzed costs by developing and comparing NPV life cycle cost projections for each option. In the overall analysis, cost was given the second heaviest weighting of the seven evaluation criteria. (Access to care had the heaviest weighting.)
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> In their July 1997 report, the consultants concluded that the Travis project could not be justified and recommended that VA take over the Mather Air Force Base hospital in Sacramento for use as an inpatient facility and establish sharing agreements with community hospitals in the East Bay and Redding areas. Of

[4] OIG, Audit of Veterans Health Administration Major Medical Equipment Acquisition (5R4-E01-120), September 1995.
[5] GAO, VA Healthcare: Travis Hospital Project Is Not Justified (GAO/HEHS-96-198), September 1996.

particular note, the cost analysis showed that the Travis proposal life cycle costs ($1.13 billion) were more than twice as high as those of the recommended option ($518 million) and were significantly higher than the other alternatives ($429 million - $856 million).

Just as the Brevard decision showed that alternatives to VA traditional approach were feasible, the Travis study showed that it was possible to effectively use benefit-cost data to evaluate a proposed VA capital investment. The study's analysis was significant in that it identified the substantial cost differences among the alternative proposals and highlighted the very high cost of the original Travis proposal. The analysis also demonstrated that the pertinent benefit-cost data can be developed for even very complex alternatives such as were evaluated in this study. This further illustrates the important role of benefit-cost analysis in selecting cost-effective alternatives and demonstrates the potential for broader use in VA capital decision-making.

Recent VA Initiatives Recognize the Need to Improve Capital Planning. Both VA's new Capital Investment Board (CIB) and VHA top management have recently undertaken initiatives to ensure that capital planning include both consideration of alternatives and benefit-cost analysis of these alternatives:

- The CIB will require that high cost capital investment proposals submitted for review must address the following questions pertaining to alternatives: (1) Are the functions to be addressed by the proposed asset mission-critical? (2) Can another entity perform the function better? and (3) Have business processes been reengineered to improve effectiveness? To determine potential return on investment of alternatives, the CIB will also require quantification of asset life cycle benefits and costs.

- As part of the new strategic planning process, VHA has required the VISNs to submit capital asset plans. These plans must explain why a proposed major capital investment is preferred over other alternatives, and proposals must be supported by NPV benefit-cost analysis.

- In his March 1996 publication, Prescription for Change, the Under Secretary for Health, as part of his strategy to restructure the VA healthcare system, stated that VHA should construct new facilities only when there are no other practical and cost-effective alternatives. He advocated the consideration of alternatives such as sharing with Department of Defense (DoD), community, or university providers; leasing facilities; contracting for services; renovating existing space; and exploring opportunities to acquire unused community or DoD facilities. The Under Secretary also proposed the development of specific criteria to evaluate the benefits and costs of new construction versus alternative service delivery options.

Additional Policy Is Needed for VISN-Controlled Investment Decisions

The initiatives discussed above are positive steps toward improving VA's capital decision process. However, so far these initiatives have been directed toward only the most expensive investments that require VA Central Office-level approval, such as construction projects over $3.0 million. VA and VHA policy does not specify to what extent capital programming

principles should be applied to investments that are controlled at the VISN level and that fall below the VA Central Office review thresholds. In FY 1998, these VISN-controlled investments could amount to as much as $979.6 million, or 95.4 percent of VHA's proposed FY 1998 capital expenditures.[6]

In the Capital Programming Guide, OMB recognized that some capital investments are too small to warrant detailed planning and that agencies would have to weigh the level of capital programming effort against the materiality of the investment. OMB suggested that agencies adopt a stratified approach, with different levels of review required based on the relative size or importance of the investment. This multi-level approach was considered particularly appropriate for large agencies such as VA.

VA's recent initiatives represent the first steps toward the stratified, multi-level capital programming approach suggested by OMB. VA has established a two-level approach, VA Central Office-level approval required for high cost capital investments and VISN-level approval required for lower cost investments. As stated above, policy guidance has provided some direction for the capital investments requiring VA Central Office approval. However, in our opinion, additional guidance is needed to provide a capital programming framework for VISN-controlled investments.

The suggested additional guidance should address two major concerns. First, it should specify the types of capital investments that VISNs would be expected to support with the use of capital programming principles and techniques, especially the consideration of alternatives and the use of benefit-cost analysis. Second, it should include technical instruction and advice in the form of a handbook to assist the VISN and VAMC staff who will be performing the capital programming steps. For example, the technical guidance could include instructions, definitions, and illustrations for applying NPV formulas, for developing monetary cost and benefit information from VA and external sources, and for selecting the appropriate timeframes and discount rates required for NPV analysis. The guidance could also provide instructions on post-implementation review, which is a technique for comparing planned benefits to actual outcomes. Based on our discussions with VISN and VA Central Office program officials, this combination of policy and technical guidance should be helpful in applying capital programming principles to VA capital decisions at all levels.

New Funding Strategies Could Promote Better Capital Investment Decisions

VA's Capital Funding Process Has Hindered Effective Planning. VHA planners have had to make capital investment decisions within the constraints of a funding process that provides two separate sources of funds -- the medical care appropriation which funds NRM projects, equipment, and leases, and the construction appropriation which funds major and minor construction projects. Because they have been restricted by the funding process, VHA planners

[6] The $979.6 million represents VHA's proposed FY 1998 expenditures for minor construction, nonrecurring maintenance, and equipment for which funding is allocated to the VISNs using a formula-based allocation methodology. A VISN completely controls its allocation unless it proposes an asset acquisition that exceeds the VA Central Office approval thresholds.

have not always been able to seriously consider capital investment alternatives or to effectively utilize benefit-cost analysis. This problem can be illustrated by the major medical lease proposals included in the FY 1998 Congressional Budget Submission:

> VA requested funding for seven 20-year operating leases to rent space for five satellite clinics and for two information resources management field offices. The budget submission showed the results of NPV benefit-cost analyses comparing the costs of each lease versus its construction alternative. The analyses showed that for all seven proposed leases, the leasing alternative was more expensive than construction. The combined present value of the costs of the seven proposed leases was $95.5 million, which exceeded the combined costs of construction by about $15 million, or about 18.6 percent.
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> The budget submission acknowledged that construction was the lower cost alternative, but still requested funding for the seven leases, justifying this request on the basis that leasing was more "flexible." During our review we asked responsible officials why the results of the benefit-cost analyses were not followed -- that is, why was leasing preferred over the less costly construction alternative? They acknowledged that there is nothing particularly flexible about a 20-year lease and indicated that they had opted for leases because these could be funded from the medical care appropriation, whereas the construction alternatives would have been funded from the construction appropriation. To receive construction funding, proposed projects must be scored and ranked. It was considered unlikely that the construction alternatives would have scored high enough to be funded.

VA considered the new facilities to be needed. For VA the real choice was not between leasing and construction. Instead, it was between leasing and doing nothing, because under the funding process the construction alternative had no realistic chance for funding. In effect, VA officials were compelled to recommend the more costly leasing alternative in order to acquire the assets they believed were needed.

VA Should Explore the Feasibility of Using Other Funding Strategies. During our review, VA and VHA officials acknowledged that modifying the existing funding process could remove a major impediment to selecting the best capital alternatives. Based on discussions with various VA officials and on our review of a recent GAO report that examined capital budgeting issues in several Federal agencies,[7] we identified three alternative funding concepts or methods that might be feasible for VA:

- **Single Capital Investment Appropriation.** Under this concept, each VA "business line" (such as VHA) would have a single appropriation for all capital investments. This could prevent the type of problem illustrated by the leasing versus construction issue, where the

[7] GAO, Budget Issues: Budgeting for Federal Capital (GAO/AIMD-97-5), November 1996.

more costly alternative was selected simply because funds were available from one appropriation source but not from the other.

- **Revolving Fund.** A revolving fund accumulates resources over a period of years by charging using managers for the costs of maintaining, improving, or replacing an asset. Charges are paid out of operating funds. This allows the accumulation of funds that can be used for future asset acquisitions. VA has used a revolving fund to finance parking garages.

- **Working Capital Investment Fund.** Under this concept, which is relatively new to the Federal Government, managers are allowed to accumulate resources for capital acquisitions by making contributions from operating funds into the working capital fund. This differs from a revolving fund in that users make voluntary contributions for future capital purchases rather than being charged retrospectively for using capital assets.

The benefits that could result from these alternative funding strategies include: facilitating the funding of the highest priority projects; promoting more effective long-range capital planning; and making using managers more accountable for their own capital consumption.

VA officials indicated they have discussed the possibility of new funding strategies but have not formally studied the issue. While we recognize that any proposal to significantly alter the existing funding process would require OMB and Congressional approval, and possibly authorizing legislation, we believe that exploring the use of such new strategies would complement VA's other initiatives and could make VA capital programming more effective.

Conclusion

Historically, VA has not had a comprehensive capital programming process. In particular, VA generally did not consider alternatives to proposed new capital acquisitions and did not use benefit-cost analysis to support capital decisions. Our review concluded that recent VA and VHA initiatives are steps in the right direction. Thus far, VA efforts have focused on high cost, high risk capital investments that require VA Central Office approval. However, most capital decisions are now made at the VISN and VAMC levels.

In order to have a truly effective, comprehensive capital program, VA needs to: (1) develop policy on local capital decisions and (2) provide technical guidance on capital programming principles and methods for the local staff who will be analyzing capital investment options and making decisions. The policy and guidance should specifically address consideration of investment alternatives, benefit-cost analysis, and post-implementation reviews. In addition, to gain flexibility in capital decision-making and to promote the selection of the most cost-effective capital investments, VA should further explore the use of new capital funding strategies.

For More Information

- VA capital costs, asset categories, and Federal and VA capital investment initiatives are discussed in more detail in Appendix I, pages 11-20.
- The review objective, scope, and methodology are discussed in Appendix II, page 21.
- Benefit-cost analysis and post-implementation review are discussed in more detail in Appendix III, pages 23-26.

Recommendation 1:

We recommend that the Acting Assistant Secretary for Management and the Under Secretary for Health work together to:

a. Develop policy for VISN-controlled capital investments, including policy on the types of investments subject to capital programming, on dollar thresholds, and on responsibilities for considering alternatives, performing benefit-cost analysis, and meeting other capital programming requirements.

b. Develop technical guidance to assist VISN staff in performing benefit-cost analysis and other capital programming steps, such as post-implementation reviews.

c. Evaluate the feasibility of using alternative strategies for funding capital investments.

Acting Assistant Secretary for Management Comments

The Acting Assistant Secretary for Management concurred with the findings and recommendations. (See Appendix IV, page 27, for the complete text of the Acting Assistant Secretary's comments.)

Under Secretary for Health Comments

The Under Secretary for Health concurred with recommendations 1a and 1b and concurred in principle with recommendation 1c. (See Appendix V, pages 29-30, for the complete text of the Under Secretary's comments.)

Implementation Plan

a. The Acting Assistant Secretary for Management stated that VHA has the lead in developing policies for VISNs and his staff is working with them to develop policies for planning of capital programs. The Under Secretary for Health stated that VHA's Policy, Planning, and Performance Office will develop a policy for VISN-controlled capital investments as part of the policy guidance for the FY 1999-2004 VISN plans. The policy will be coordinated with the appropriate offices and issued by September 30, 1998.

b. The Acting Assistant Secretary stated that the CIB has contracted with a consultant to evaluate VA's methods for evaluating construction projects. The Board hopes that the consultant's efforts will result in revised methods for completing benefit-cost analyses and other capital programming steps. The consultant is expected to complete his project by the end of February 1998, at which time decisions on his recommendations will be made. The Under Secretary stated that the benefit-cost analysis method used for the FY 1998-2003 VISN plans will be clarified and simplified by July 1, 1998, and will be issued as part of the policy guidance by September 30, 1998. Responsibility for application and monitoring will be with the VISNs.

c. The Acting Assistant Secretary has had discussions with the various agencies about different funding strategies. He expects that the CIB will discuss and review the issue this year and that the issue will be resolved during the FY 2000 budget process. The Under Secretary stated that VHA had consulted with the Office of the Assistant Secretary for Management to determine the agency's perspective and to lay the groundwork for further discussions. The Under Secretary noted that because the funding accounts in question cross Departmental and appropriation lines there may be obstacles outside VHA's control that could hinder developing alternative strategies or implementing change. VHA will continue to work with the Department to determine the feasibility of funding alternatives.

Office of Inspector General Comments

The implementation plans are acceptable and we consider the evaluation issues to be resolved. We will follow up on the implementation of planned actions.

Background

Capital Programming Definitions and Concepts

Capital Asset. A capital asset is tangible property such as land, structures, equipment, information technology hardware and software, and intellectual property owned by the Federal Government and having an estimated useful life of 2 years or more. Capital assets may be acquired through purchase, construction, and leasing. The cost of a capital asset includes the purchase price and all other costs incurred to make it suitable for the intended use. Capital costs include both the initial acquisition cost and any additional costs for improvements, replacements, renovations, and major repairs beyond the scope of ordinary maintenance and repairs. (OMB Capital Programming Guide)

Capital Programming. Capital programming is a comprehensive process for managing capital asset investments. This process has four major phases: planning, budgeting, procurement, and management-in-use. In the private sector, where profit is the most important concern, economic analysis techniques, such as benefit-cost analysis, are extensively used to assess the impact of a proposed capital project on profitability. In VA and other Federal agencies, where there has been no profit element, capital programming decisions have been typically based on general evaluation techniques, which emphasize such factors as program goals, social and legal concerns, and other perceived needs of the agency.

VA Capital Asset Categories and Costs

In FY 1997, VA capital investment expenditures totaled about $1.33 billion. VHA's capital spending in support of the healthcare delivery system accounts for most of VA's total capital investments. In FY 1997, VHA capital expenditures were an estimated $1.17 billion, or about 88.0 percent of total VA capital investment. Most VHA capital investments are funded from two major sources -- the medical care and the construction appropriations.

Medical Care Appropriation. The two major asset categories funded from the medical care appropriation are equipment and lands and structures:

- **Equipment.** The equipment asset class covers durable property such as medical diagnostic equipment, data processing and telecommunications equipment and software, furniture, and vehicles.

- **Lands and Structures.** This asset class includes NRM projects and capital leases. NRM projects are intended to maintain, repair, or modify existing buildings. These projects may also be used to upgrade or replace major building systems such as utilities, security, and patient care support. NRM projects may include a minor improvement component to add space or to make other minor structural or infrastructure changes. Individual NRM projects

do not have a set cost limit except that cost of a minor improvement should not exceed $500,000 (for FY 1998 projects).

Capital leases are lease-purchase agreements for acquiring buildings and are treated as capital assets. Historically, VA has not extensively used capital leasing as a means of acquiring property.

Construction Appropriation. The two major asset categories funded from the construction appropriation are major and minor construction projects:

- **Major Construction.** The major construction category includes capital projects costing $3.0 million ($4.0 million beginning in FY 1998) or more that are intended to design, build, alter, extend, or improve a VA facility. As part of the VA budget process, Congress reviews, approves, and funds major construction on a project-by-project basis. Typical major construction projects are replacement hospital buildings, large ambulatory care additions, and new hospitals or nursing homes.

- **Minor Construction.** The minor construction category covers projects estimated to cost less than $3.0 million ($4.0 million beginning in FY 1998). Before FY 1997, minor projects were reviewed and approved for funding at the VHA headquarters level. As part of the VHA reorganization, minor projects are now approved at the VISN level.

The construction appropriation also includes several smaller funding accounts, such as the parking garage revolving fund and grants to States to construct extended care facilities. Table 1 summarizes VHA capital expenditures for FYs 1993-1998:

Table 1. VHA Capital Expenditures -- FYs 1993-1998 ($ Millions)

Appropriation/Class	1993	1994	1995	1996	Estimated 1997	Requested 1998
Medical Care						
Equipment	$531.0	$487.5	$526.6	$632.8	$566.9	$570.9
Lands and Structures	211.1	202.2	312.0	187.1	256.0	268.2
Subtotal	742.1	689.7	838.6	819.9	822.9	839.1
Construction						
Major	467.9	397.0	303.2	116.1	201.8	47.5
Minor	125.0	122.5	126.9	169.8	142.8	140.5
Subtotal	592.9	519.5	430.1	285.9	344.6	188.0
Total	$1,335.0	$1,209.2	$1,268.7	$1,105.8	$1,167.5	$1,027.1

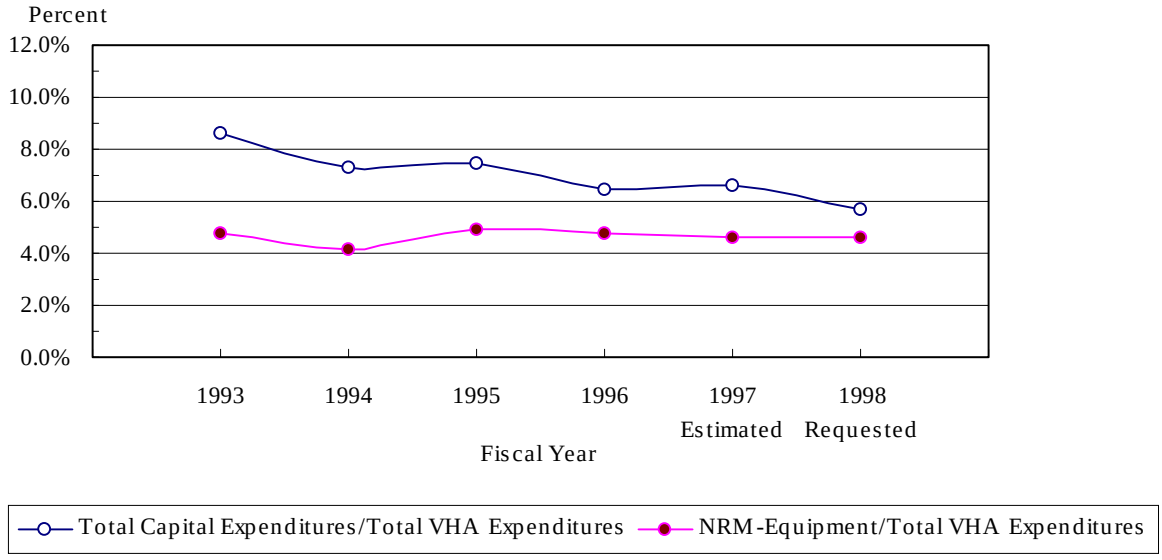
Sources: VA Congressional Budget Submissions and VA Office of Management

Operating Leases. While not considered capital expenditures in accounting or budget terms, operating leases are an alternative method of obtaining building space for program operations. Operating leases differ from capital leases or lease-purchases in that VA does not secure ownership of the asset. In recent years, VHA's operating lease costs have increased

significantly, from $66.8 million in FY 1993 to $87.8 million in FY 1997, an increase of 31.5 percent over the 5-year period. VHA has suggested the increased use of leases to more quickly add new patient care access points in locations away from VAMCs.

VHA Capital Expenditure Trends. Over the past few years, VHA capital expenditures have been fairly constant. During the 5-year period FYs 1993-1997, total VHA capital expenditures averaged about $1.22 billion and ranged from a high of $1.34 billion in FY 1993 to a low of $1.11 billion in FY 1996. As shown in Figure 1 below, aggregated capital expenditures from the medical care and construction appropriations averaged 7.3 percent of total VHA expenditures and ranged from a high of 8.6 percent in FY 1993 to a low of 6.5 percent in FY 1996. Capital expenditures from only the medical care appropriation (NRM, leases, and equipment) averaged 4.7 percent and ranged from a high of 5.0 percent in FY 1995 to a low of 4.2 percent in FY 1994. Based on VA's budget submission for FY 1998, aggregated capital expenditures from both the construction and the medical care appropriations would total 5.7 percent of VHA's total budget. Expenditures from only the medical care appropriation would total 4.6 percent.

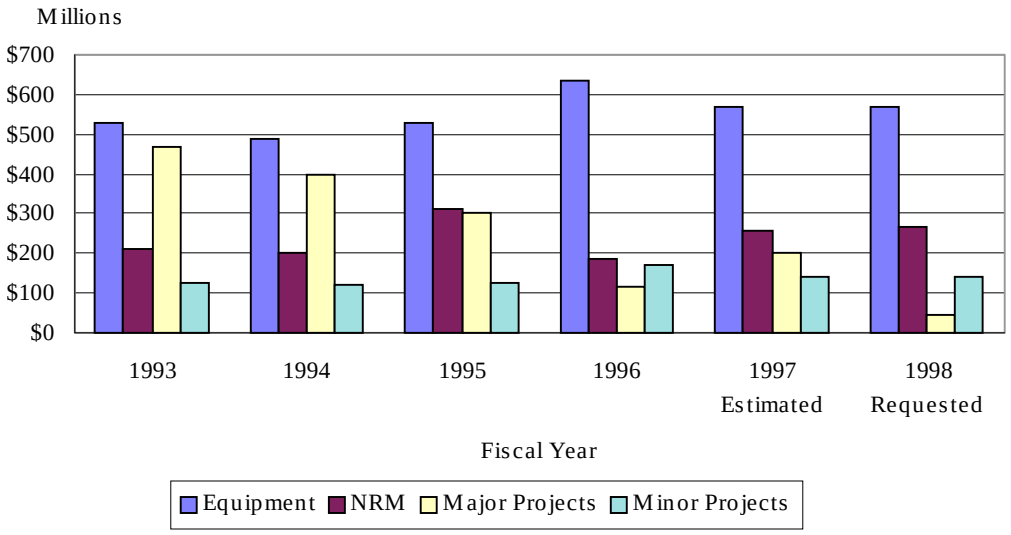
Figure 1. Capital Expenditures As A Percentage of Total VHA Expenditures



Source: VA Congressional Budget Submissions

While overall capital expenditures have experienced a slight downward trend, there have been year-to-year fluctuations, or "spikes," in expenditures within specific capital categories, as shown in Figure 2. For example, the largest annual decrease in total VHA capital expenditures was $163 million between FYs 1995-1996 ($1.269 billion in FY 1995 to $1.106 billion in FY 1996) while two of the categories had their largest increases. Equipment increased by $106 million and minor projects increased by $43 million. However, these increases were more than offset by the decreases in the NRM and major construction categories, which resulted in the overall decrease in total capital expenditures.

Figure 2. VHA Capital Asset Expenditures by Categories (FYs 1993 - 1998)



Sources: VA Congressional Budget Submissions

Federal Sector Capital Investment Concerns and Initiatives

Government-wide initiatives such as the Government Performance Results Act of 1993 (the Results Act) and the National Performance Review have promoted the integrated use of mission statements, strategic plans, performance measures, and budgets to better manage Federal agency program activities, resources, and costs. OMB and Congress have recently established new guidelines and requirements for agencies to use in improving the acquisition and management of capital assets. The most significant of these initiatives are described below.

OMB Capital Programming Guide. In July 1997, OMB issued the Capital Programming Guide, which was designed to supplement existing guidance on budget submissions for proposed capital investments (OMB Circular A-11, Part 3) and to provide a basic reference on the principles and techniques for capital programming in the Federal Government. The Guide describes the requirements of recent reform legislation such as the Results Act and it discusses capital investment concepts and techniques used in the private sector and described in various textbooks and journal articles. The Guide lays out a comprehensive set of 25 principles for managing capital investments over the entire asset life cycle, from project inception through disposal. The 25 principles are grouped into the 4 phases of planning, budgeting, procurement, and management-in-use:

- **Planning.** The Guide emphasizes that the planning for capital assets should be directly linked to the goals and objectives of agency strategic plans and program performance plans. Before planning to acquire capital assets, managers should decide if existing resources allow them to meet the goals and objectives of agency plans. If not, managers should examine

alternatives for closing the performance gap between existing and planned capabilities. Managers should consider alternatives to new capital assets, such as process streamlining and contracting out. The Guide suggests formal, systematic benefit-cost analysis as the primary method of comparing alternatives and selecting the best solution within budget constraints. The results of the planning steps should be presented in an agency capital plan that has been developed through a prescribed formal review process.

- **Budgeting.** The Guide describes the steps by which the agency requests budget authority for the proposed capital acquisition. The steps include the budget submission, passback agency revision, approval for the President's Budget, and Congressional review. During the budgeting phase, the agency may be required to defend its proposal, revise elements of the proposal, or evaluate alternatives for funding the proposal.

- **Procurement.** This phase begins once Congress has approved project funding. The first step is to validate that the original planning decision is still appropriate. The agency should then follow the steps required to manage procurement risk, select the pricing mechanism, issue the solicitation, evaluate the proposals, award and manage the contract, and test for acceptance of the completed capital project.

- **Management-In-Use.** In this phase the agency should implement an operations and maintenance plan and should perform a post-implementation review to determine if the asset is performing as planned and to ensure continual improvement of the asset management process based on lessons learned.

OMB Circular A-11, Part 3. In July 1996, OMB issued Circular A-11, Part 3, Planning, Budgeting, and Acquisition of Fixed Assets, which provided guidance on the new information requirements for proposed capital asset acquisitions that were to be included in agency FY 1998 budget submissions. OMB required that agencies provide an agency capital plan with information on individual projects, including a summary of full funding requirements for all project segments, project justifications, and project goals for cost, schedule, and performance. The OMB guidance also provided unified instructions on agency reporting requirements of various related initiatives, such as the Results Act. For VA, OMB required this information for various high cost construction, equipment, information technology acquisitions, and leases.

OMB Circular A-94, Guidelines and Discount Rates for Benefit-Cost Analysis of Federal Programs. This circular provided guidance for conducting benefit-cost analysis as part of agency planning activities and preparation of budget submissions. The purpose of the circular was to promote well-informed decisions by Federal agencies to initiate, renew, or expand projects or programs.

Benefit-cost analysis, the recommended technique for formal economic analysis, is defined as a "systematic quantitative method of assessing the desirability of government projects when it is important to take a long view of future effects." (OMB Circular A-94, Appendix A) The preferred method for performing benefit-cost analysis is net present value. NPV is the discounted monetary value of expected net benefits and is calculated by assigning monetary

values to benefits and costs, discounting future values of benefits and costs using an appropriate discount rate, and subtracting the sum total of discounted costs from the sum total of discounted benefits.

In addition to NPV, the circular discusses four other elements of benefit-cost analysis: (1) the rationale for the proposed project; (2) the underlying assumptions, such as the number of future beneficiaries, level of services, and cost increases; (3) evaluation of alternatives such as doing nothing, acquiring an asset, upgrading an existing asset, leasing, or contracting for services; and (4) verification to determine whether anticipated benefits and costs have been realized. The circular also recognizes the potential risks of uncertainty and imprecision in the assumptions and data used in the analyses.

VA officials told us that formal economic analysis using NPV or other quantitative methods have not been employed in most capital planning activities. For example, VA's processes for justifying and evaluating major, minor, and NRM projects have not required financial analysis of the costs and benefits of a proposed project versus the alternatives to the project.

Information Technology Management Reform Act of 1996 (ITMRA or Clinger-Cohen Act). The purpose of the Clinger-Cohen Act was to promote improvements in the use of information technology (IT) in support of agency missions and to improve agency management processes for acquiring and managing IT investments. The Act provided uniform definitions for the various components of IT and set IT responsibilities within the Federal government. The Act made OMB responsible for establishing government-wide direction for improving the acquisition, use, and disposal of IT investments and for enforcing the direction through budget processes. The Federal agency responsibilities defined in the Act include: (1) capital planning and investment control; (2) performance/results-based management and reporting requirements; (3) appointment of an agency Chief Information Officer; and (4) exception reports on major IT acquisitions that have significantly deviated from cost, performance, or schedule goals.

Government Performance and Results Act of 1993. To a great extent the OMB, legislative, and VA capital investment initiatives discussed above are built on or share the performance-based management concepts and requirements of the Results Act. The Act was passed to provide a comprehensive legislative framework for improving the efficiency and effectiveness of Federal programs by requiring agencies to set goals for program performance and to measure results. Under the Results Act, agencies must establish strategic goals, measure performance, and report on accomplishments and the degree to which goals were met.

To meet these requirements, by the end of FY 1997 agencies must have developed 5-year strategic plans that include mission statements, identify long-term strategic goals, and describe how the agency intends to achieve the goals through its activities and resources (including capital assets). The strategic plans serve as the starting point for setting goals and measuring program performance in achieving the goals. Also by the end of FY 1997, agencies must have submitted their first annual performance plans to OMB. These plans contain the performance goals and performance measures that will be used to assess program success in meeting the goals outlined

in the strategic plan. Agencies will be required to submit to OMB and Congress an annual report on program performance for the previous fiscal year. (The first report will cover FY 1999.)

Recent VA Capital Investment Initiatives

As part of recent restructuring and management improvement efforts and in response to external requirements, VA and VHA have undertaken a number of initiatives that address capital investment issues.

Prescription for Change. In a March 1996 publication, Prescription for Change, the Under Secretary for Health outlined his goals, objectives, and proposed actions to carry out the restructuring of the VA healthcare system. Several of the proposed actions addressed capital investment issues, including:

- Develop specific criteria to evaluate the benefits and costs of new construction versus alternative service delivery options.
- For major construction projects, demonstrate consideration of alternatives such as sharing with non-VA facilities, contracting for services, or leasing facilities.
- Explore acquisition of vacated community or DoD facilities.
- Add a benefit-cost element to the construction prioritization system.
- Expand use of leased space for outpatient and nursing home care.
- Develop and implement a methodology for major medical equipment acquisitions.

It should be noted that these proposals share or are based on the Results Act and on the capital budgeting principles and objectives described earlier in this appendix.

VA Survey of Private Sector Capital Processes. In 1997, the Office of Management had a survey conducted of capital planning and budgeting practices used by eight private healthcare providers. The survey, entitled Capital Allocation and Management: A Study of Eight Healthcare Delivery Systems, summarized how these providers allocated and managed financial capital.

Among the eight providers surveyed, capital investments ranged between 10-30 percent of total annual expenditures. All the providers funded capital investments primarily from retained earnings and to a lesser extent from debt. They all used a two-phase process -- capital planning and capital expenditures review -- to allocate and manage capital investments. Capital planning was defined as the process of identifying capital needs and planning the distribution of capital throughout the organization to meet those needs. Capital expenditures review is the oversight of actual capital expenditures to ensure they were consistent with the organization's goals and objectives after the budget had been approved but before the expenditure was actually made.

Generally, the biggest difference between private sector and VA approaches to capital planning were (1) the sources of funding (corporate earnings or debt versus VA appropriations) and (2) greater segmentation in the VA capital plan because of the two major appropriations sources (construction and medical care) that fund most VA capital expenditures. Another important difference was that VA's capital expenditure review processes were not as comprehensive as those of the surveyed providers. VA procedures have not generally required in-depth analysis after funding has been approved and have not included substantial analysis of the economic impact of the investment. Also, VA managers generally have not been held to the same level of oversight on the financial performance of their decisions.

The VA Office of Management used the study results in its initiative to establish the Capital Investment Board and to define the Board's role in overseeing VA's capital investments.

VA Capital Investment Board. In June 1997, VA established a new top management oversight group, the Capital Investment Board, as a way to address capital programming issues. The CIB is chaired by the Deputy Secretary, and the board members are the Under Secretaries for Health and for Benefits, the Director of the National Cemetery Service, and the Assistant Secretaries for Policy and Planning and for Management. It should be noted that the CIB initiative incorporates a number of OMB's capital programming principles and has some of the characteristics of the corporate capital investment steps reported in the survey of non-VA providers.

The CIB was proposed by the Assistant Secretary for Management, who stated in his proposal that the CIB would help address various weaknesses in existing VA capital policies. He acknowledged that VA did not have clear capital investment policies in place and that the lack of such policies had encouraged splintered, fragmented, and inconsistent capital investment decisions. In the past many of these decisions were deficiency driven, implemented in a vacuum, with little or no consideration given to other VA projects, and were not integrated to ensure that they supported strategic plans, goals, and objectives.

The major responsibilities of the CIB include:

- Ensuring that VA has a sound capital investment policy.
- Ensuring that an agency capital plan is developed to support annual budget requests and VA strategic plans.
- Reviewing specific capital investment proposals that have high risk, national visibility, or are above certain cost thresholds.
- Implementing OMB capital programming principles to close gaps in existing VA capital investment policies.

The CIB will review projects at two stages: conceptual and operational. At the conceptual stage, the CIB will decide on the concepts for the proposals to be included in the agency capital plan in advance of the 5-year planning and budget process. After funds are appropriated, the CIB will

approve the actual initiation of acquisitions. This second review will give the board an opportunity to validate the acquisition decision.

VISN Strategic Plans. In December 1996, the 22 VISNs submitted their first strategic plans to VHA. These plans included VISN capital initiatives and investments necessary to meet strategic goals for the 5-year planning period. VHA instructions to the VISNs called for: a description of capital resources/infrastructure needed to accomplish the strategic plan; an assessment of existing capital resources (inventory and condition of current assets); and a description of required actions and alternatives.

The VISN plans were rolled into VHA's overall strategic plan, which was published in April 1997 as the VHA Journey of Change. The capital portions of the VISN strategic plans will serve as the basis of VHA's capital plan as required by OMB Circular A-11, Part 3.

VHA Decentralization of Capital Investment Authority and Formula-Based Distribution of NRM, Equipment, and Minor Construction Funds. In January 1997, VHA announced the adoption of a new resource allocation methodology called Veterans Equitable Resource Allocation (VERA). VERA had new models for allocating funding for equipment and non-recurring maintenance. A similar model was developed to distribute construction appropriation funding for minor projects. One of the most significant changes was the discontinuance of VHA headquarters-level participation in the review and funding approval process for individual projects or acquisitions. The VISNs were delegated the authority and responsibility for making project approval and funding allocation decisions for all but the highest cost acquisitions:

- **Equipment**. In FY 1997 VHA allocated $353.0 million to VISNs based on a new formula that takes into account clinical case mix (50 percent), patient workload (25 percent), and existing equipment inventory value (25 percent). This new formula places more weight on patient workload and less weight on existing equipment.

- **Nonrecurring Maintenance.** VHA allocated $236.0 million to VISNs based on a new formula that takes into account building square footage and age, regional construction cost differences (90 percent), and patient workload (10 percent). Compared to the old allocation process, this new formula somewhat reduced the formula weighting for existing buildings and increased the weighting for patient workload.

- **Minor Construction.** VHA allocated $148.0 million to VISNs based on a new formula that takes into account building square footage and age, regional construction cost differences (70 percent), and patient workload (30 percent). This new allocation method eliminated headquarters review of individual projects and gave VISNs greater autonomy and flexibility in funding minor projects.

Veterans' Healthcare Eligibility Reform Act of 1996. The Veterans' Healthcare Eligibility Reform Act of 1996, Public Law 104-262, was enacted in October 1996. The law contained provisions to simplify eligibility rules, to expand VHA's sharing and contracting authority, and to add new strategic, capital planning, and reporting requirements. The law eliminated many

existing barriers to sharing and contracting for healthcare services and resources with non-VA entities. VHA Directive 97-015, issued in March 1997, provided VISNs and facilities with initial implementing instructions. VA is in the process of publishing new regulations to establish the simplified competitive acquisition procedures authorized by the Act. The main impact of the Act on capital investment is that it should allow VHA to more extensively use alternatives to capital investment, especially contracting out for services.

Reduced VHA Major Construction Request for FY 1998 Budget Submission. In a departure from past practices, VA's original FY 1998 budget submission did not request funding for any new major VHA construction projects. The only major project funding requested (other than for advance planning and design funds and for asbestos abatement and seismic vulnerability studies) was $34.6 million for completing the previously authorized and partially funded VAMC Memphis Seismic Corrections project. As shown on page 12, VHA's major construction request totaled $47.5 million, which was substantially less than the $201.8 million appropriated in FY 1997 and the $116.1 million appropriated in FY 1996. VHA officials indicated that they did not propose any new major projects because they were not yet in a position to support such projects under the more demanding justification requirements for the FY 1998 budget submission.

VA Information Technology Initiatives. In some respects, capital investment initiatives for IT have made more progress than have initiatives for other types of assets. VA's Office of Information Resources Management (OIRM), an element of the Office of Management, is in the process of revising policies to meet the requirements of the Clinger-Cohen Act and related OMB initiatives. The most significant development is the September 1997 VA Directive 6000, VA Information Resources Management Framework. The purpose of this new policy directive is to establish an IT management framework and to define the responsibilities for planning, budgeting, procurement, and management in-use of IT assets.

Some of the other IT initiatives that are underway or that have been accomplished include the development of an IT strategic plan to be completed for the FY 1999 budget cycle, the compilation of an initial IT operating plan for FY 1997, the submission of the capital budgeting information in support of major IT acquisitions included for funding consideration in the FY 1998 budget submission, and the publication of an Information Technology Baseline Report in April 1996.

Objective, Scope, and Methodology

Objective

The objective of this evaluation was to assess VA's capital asset acquisition practices and VA's progress towards implementing a capital programming process.

Scope and Methodology

To meet the review objective, we interviewed officials of OMB's Office of Federal Procurement Policy and reviewed OMB's Capital Programming Guide, related budget directives, other published guidelines, and recent legislation. We also performed a literature review of capital investment planning and management issues and practices.

Because VHA accounts for about 88.0 percent of VA's capital costs, our review focused on VHA capital investment issues. We interviewed officials in VHA and in VA's Office of Management program offices responsible for capital budgeting and oversight, strategic planning, facilities management, information technology, and budget formulation and allocation. We reviewed pertinent documents including VHA and VISN strategic plans, budget submissions, VISN capital plans, project justifications, and other related documents. We also reviewed OIG and GAO audit reports that discussed issues related to VHA capital asset planning and management. To better understand VISN-level capital programming issues we interviewed officials and reviewed pertinent documents at the office of VHA's Northwest Network (VISN 20) and at two of the Network's VAMCs, Portland and Seattle.

The evaluation covered the status of VA's capital programming practices and initiatives during FY 1997. In performing this evaluation we followed the applicable generally accepted government auditing standards.

Details of Evaluation

Benefit-Cost Analysis Showed High Cost of Long-Term Leases

Because of the constraints of the funding process, VA officials have not always been able to select the most cost-effective alternative or make good use of benefit-cost analysis. However, the potential value of benefit-cost information can be illustrated by the NPV estimates prepared for VHA's major medical lease proposals, which represented VA's most extensive use of benefit-cost analysis.

To meet Congressional reporting requirements, VA includes in the annual construction budget submission a prospectus for each proposed lease that would have annual rental costs exceeding $300,000. In the FY 1998 budget submission, VA requested funding for seven proposed 20-year leases. The budget submission showed the results of a NPV analysis for each lease and for its construction alternative. These analyses were somewhat limited in that they compared life cycle costs and did not fully account for the monetary benefits for each alternative. Even so, the analyses did provide useful data on the cost differences between the lease and construction alternatives.

As presented in Table 2 below, the analysis showed that for all seven projects leasing was more expensive than the construction alternative.

Table 2. Net Present Values of Proposed Leases and Construction Alternatives ($ Millions)

Proposed Lease	NPV of Lease	NPV of Construction	Difference	Percent Difference
Boston Satellite Outpatient Clinic	$36.7	$29.8	$6.9	23.0
Canton Satellite Outpatient Clinic	11.4	10.2	1.2	11.6
Jacksonville Satellite Outpatient Clinic	14.6	12.4	2.2	18.0
Portland Satellite Outpatient Clinic	12.0	11.2	0.8	7.0
Tulsa Satellite Outpatient Clinic	11.4	9.5	1.9	20.4
Birmingham IRM Field Office	4.4	3.6	0.8	21.7
Salt Lake City IRM Field Office	5.0	3.8	1.2	31.6
Combined	$95.5	$80.5	$15.0	18.6

Source: FY 1998 VA Congressional Budget Submission

The combined present value of the costs of the seven proposed leases was $95.5 million, which exceeded the combined construction costs of $80.5 million by $15.0 million, or about 18.6 percent. The cost of leasing exceeded the cost of construction by a range of $786,000 higher (Portland) to $6.9 million higher (Boston). On a percentage basis leasing costs were higher by from 7.0 percent (Portland) to 31.6 percent (Salt Lake City).

In the budget submission VA acknowledged that construction was the lower cost alternative, but justified leasing on the basis that it was a more "flexible" option. A typical justification stated: "VA considered lease acquisition and federal construction alternatives for providing the space. However, in the rapidly changing healthcare environment, VA has determined that the flexibility of leasing provides the preferred alternative to meeting the unknown future demands of VA clients." (FY 1998 VA Congressional Budget Submission, Vol. 3, page 10-6)

While leases are considered to be a more flexible option than construction to meet short-term needs, they can be more costly over the asset life when used to meet long-term needs. As discussed on page 6, VA officials were compelled to select the more costly leasing alternative in order to acquire the assets they had determined were needed.

VA Can Build on Recent Efforts to Apply Benefit-Cost Analysis

Benefit-Cost Analysis Is a Valuable Tool. VA and VHA management have recognized the value and importance of benefit-cost analysis and have begun incorporating benefit-cost requirements into the processes for reviewing high cost capital investment proposals. In July 1997, VHA added a new benefit-cost analysis requirement to its Capital Asset Prioritization Methodology. Under this new requirement, VISNs were required to prepare a NPV benefit-cost analysis for major construction projects and acquisition proposals being considered for the FY 1999 budget submission. The new VA top management-level CIB also required the benefit-cost element to be included in project submissions being considered for conceptual approval by the CIB. VHA had a consultant develop a NPV training module, and presentations on the new methodology were made at conferences attended by VISN staff.

We discussed the new benefit-cost analysis requirements with Office of Management, VHA, and VISN officials and with staff of the VHA Management Sciences Group who developed the new methodology. Generally, these officials considered the new requirements to be a significant improvement in the capital investment process, but they acknowledged that it may take some time and additional effort before benefit-cost analysis is accepted and effectively applied, especially at the VISN and VAMC levels.

We agree that requiring benefit-cost analysis requirements for major investments is a major step forward. However, from our discussions and review of the policy and methodology, we think there are two additional issues that VA and VHA should address: extending benefit-cost analysis to more of VA's capital investments, and providing more technical assistance to VISNs.

Benefit-Cost Analysis Is Not Applied to Most Capital Investments. Currently, the new benefit-cost analysis requirement applies only to the highest cost investments, such as major construction. A substantial majority of the capital investment decisions, essentially all those that are now made at the VISN level, are now being made without economic analysis of the benefits and costs for proposed investments and potential alternatives. Additional policy could provide a more structured framework for VISN-level capital programming requirements. This policy should specify the types of investments and other considerations, such as cost, for which VISNs

should apply capital programming principles and techniques, such as the use of benefit-cost analysis and consideration of alternatives.

Additional Technical Guidance Could Improve VISN Benefit-Cost Analyses. VHA's initial July 1997 instructions on performing benefit-cost analysis for high cost investments provided only limited information on the type of data and assumptions to be used. VISN staff told us that they had difficulty developing their first formal NPV benefit-cost analyses in the short timeframe they had. In addition to the general lack of experience and familiarity in performing NPV analysis, VISN officials expressed concerns about the availability of relevant data and about the consistency and comparability of analyses prepared by different VISNs.

VISN staff also had concerns about the availability of data to quantify monetary costs and especially monetary benefits in their benefit-cost analyses. In typical private sector applications, the benefit component of NPV calculations is based on the revenues or cash flow attributable to the investment alternatives being evaluated. For VA, a different approach is required because VA medical facilities provide services at little or no cost to patients and generate little revenue. The VHA guidance suggested applying Health Care Financing Administration (HCFA) national reimbursement price rates to projected future clinical services attributable to the capital investment, which would produce a "proxy" revenue or benefit estimate. VHA officials acknowledged that while the HCFA information is available, it is difficult for inexperienced staff to obtain and apply this information.

VHA and VISN officials also expressed concern about the conformity and consistency of the benefit-cost analyses done by the different VISNs. According to these officials, there was no process to validate the data and assumptions used in the various analyses, and post-implementation reviews had not yet been done to provide a base of knowledge on the validity of the assumptions.

Given that benefit-cost analysis is a new function for VISNs and that staff lack experience in developing the necessary data to quantify life cycle benefits and costs, we believe that the development of additional technical guidance will be beneficial. Technical instruction, such as in the form of a handbook to help VISN and VAMC staff who will be performing the analyses, could include step-by-step instructions, definitions, data sources for both VA and external information, and illustrations for applying NPV techniques. This type of technical guidance should improve the quality of benefit-cost analyses and help VISN staff become more skilled and comfortable in performing the analyses, which in turn will help promote a broader use of these techniques in making capital decisions.

Post-Implementation Reviews Could Provide Useful Information on Investment Success

A post-implementation review (PIR) is an accepted capital programming technique for evaluating the overall effectiveness of an agency’s capital planning and acquisition process. The objectives of a post-implementation review are to (1) identify whether the asset is performing as

planned; (2) ensure continual improvement of an agency's capital programming process based on lessons learned; and (3) minimize the risk of repeating past mistakes. PIRs can help managers answer such questions as: Did the project meet its planning goals? Have conditions or assumptions changed? Was the approach used outdated or ineffective? (OMB Capital Programming Guide, page 53)

PIRs should compare actual results against planned costs, returns, and risks. The PIR should determine whether the benefits derived from the new asset were accurately predicted. The results of the PIR can provide "lessons learned" input for changes to the capital programming process and strategies.

In the past, VA has performed less detailed post-investment analyses called post-occupancy evaluations (POEs) for certain construction projects. However, POEs were aimed toward evaluating construction planning and engineering processes, not toward evaluating the overall success of the investment, which is the objective of PIRs. According to VHA officials, after about FY 1992 POEs became a low priority, resources were reduced, and eventually POEs were no longer performed.

VHA facility and planning officials agreed that PIRs could significantly improve capital planning by (1) determining how close planned performance met actual performance; (2) by learning from past experiences, and (3) implementing corrective actions and continual improvements into ongoing capital planning. PIRs should not require significant resource expenditure and should provide positive value to the capital programming process.

Acting Assistant Secretary for Management Comments

Department of Veterans Affairs

Memorandum

Date: January 1, 1998

From: Acting Assistant Secretary for Management (004)

Subj: Draft Report: Review of VA Capital Programming Practices and Initiatives (Project No. 6R8-100)

To: Assistant Inspector General for Auditing (52)

1. My staff has reviewed the draft report and I wholeheartedly agree with the findings and recommendations. I commend your staff for an excellent review of the program and solicit your continued efforts to identify areas for improvement in the capital program arena.

2. In regards to the specific recommendations I have the following comments:

- Recommendation 1a, develop policy on VISN-controlled capital investments; VHA has the lead in developing policies for the VISNs and my staff is working with them to develop policies for planning of capital programs.
- Recommendation 1b, develop technical guidance in benefit-cost analysis and capital programming steps; the VA Capital Investment Board currently has under contract a consultant to evaluate our methods for evaluating projects. As a result of the consultant's efforts we hope to have revised methods for completing benefit-cost analysis and capital programming steps. The consultant is expected to complete his project by the end of February 1998 at which time a decision concerning his recommendations will be made. Until these decisions are made and evaluated it would be premature to develop guidelines for the VISNs to follow. In the near future I will share a copy of the consultant's draft report with you and I solicit your comments.
- Recommendation 1c, explore the feasibility of using alternative strategies for funding capital investments; I have had several discussions with the agencies about different funding strategies, such as enhanced use leasing, property disposal options, and consolidating appropriations. As the Capital Investment Board matures this year it will be an issue for discussion and review and I expect that we will resolve this during the FY 2000 budget process.

3. If you have any questions please contact Mr. James M. Sullivan at 273-5254.

(Original signed by Stanley R. Sinclair for:)
D. MARK CATLETT

cc: Under Secretary for Health (10)

VA Form 2105
Mar 1989

Under Secretary for Health Comments

Department of Veterans Affairs

Memorandum

Date: January 21, 1998

From: Under Secretary for Health (10/105E)

Subj: OIG Draft Report, *VA Capital Programming Practices and Initiatives,* Project No. 6R8-110

To: Assistant Inspector General for Auditing (52)

1. The appropriate offices in the Veterans Health Administration (VHA) reviewed the draft report. We generally concur with the recommendations.

2. In response to recommendation 1a, a policy for Veterans Integrated Service Network-controlled capital investments will be coordinated in VHA by the Office of Policy and Planning (105), in conjunction with the Chief Network Office and Facilities Management Office, as part of the FY 1999-2004 network plan policy guidance. This policy will be issued by September 30, 1998. In response to recommendation 1b, the benefit-cost analysis used for the FY 1998-2003 network plans will be clarified and simplified by July 1, 1998. It will be made part of the policy to be issued by September 30, 1998. Responsibility for application and monitoring will be with the VISNs.

3. We concur in principle that alternative strategies for funding capital investments should be evaluated for use in VA. There have been discussions within the Department to attempt to develop an understanding of and gain consensus on the issues involved. In addition, VHA consulted with the Assistant Secretary for Management's Office (004) to determine the agency perspective and to lay the groundwork for further discussions. Nevertheless, as two of the accounts referenced in your report (major and minor construction) cross Department and appropriation boundaries, there are some obstacles, which are outside VHA's control, which may hinder the feasibility of developing alternative strategies or implementing change. VHA will continue to work with the Department to determine the feasibility of the alternatives suggested in the report, however, due to the preliminary stage of the discussions, at this time we cannot provide a completion date for considering these alternatives. Indeed, these obstacles may hinder developing solutions or implementing any change.

4. I understand that technical comments provided by VHA program offices regarding statements on the Nursing Home Revolving Fund and changes to the minor

VA Form 2105
Mar 1989

Under Secretary for Health Comments, Continued

2. Assistant Inspector General
For Auditing

construction category funding threshold have already been incorporated into the report by your office.

5. Thank you for the opportunity to review the draft report. If you have any questions, please contact Paul C. Gibert, Jr., Director, Management Review and Administration Service (105E), Office of Policy and Planning, at 202.273.8360.

(Original signed by:)
Kenneth W. Kizer, M.D., M.P.H.

VA Form 2105
Mar 1989

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